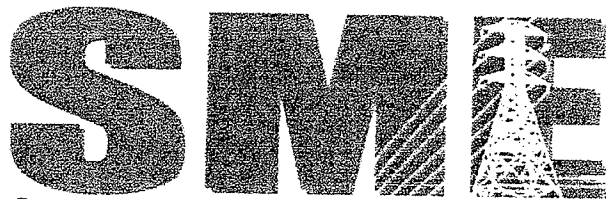


EVALUATING POWER SUPPLY SOLUTIONS IN UNCERTAIN TIMES



Southern Montana Electric
Generation & Transmission Cooperative, Inc.

2009 ANNUAL REPORT

BOARD OF TRUSTEES AND GENERAL MANAGER

- President Bill FitzGerald, Mid-Yellowstone Electric Cooperative, Inc.
- Vice President John Prinkki , Beartooth Electric Cooperative, Inc.
- Secretary/Treasurer Joe Dirkson, Fergus Electric Cooperative, Inc.
- Trustee Gary Helm, Tongue River Electric Cooperative, Inc.
- Trustee Dave Kelsey, Yellowstone Valley Electric Cooperative, Inc.
- Trustee Coleen Balzarini, City of Great Falls
- CEO/General Manager Tim Gregori



FRONT ROW LEFT TO RIGHT:
Dave Kelsey, Gary Helm, Tim Gregori

BACK ROW LEFT TO RIGHT:
John Prinkki, Joe Dirkson, Bill FitzGerald
(Not Pictured: Coleen Balzarini)

STAFF

- LEFT TO RIGHT:
- Carrie Boysun, Accountant
- Troy Dahlgren, Engineer/Power Scheduler
- Leisette Hunt, Secretary



ANNUAL MEETING AGENDA

Registration: Parish Center-Rover

10:45 am

Start

Business Session: Order of Business

11:00 am

Invocation: *John Deane, Vice President*
 Prayer: *John Deane, Vice President*
 Invocation: *John Deane, Vice President*

President: Bill FitzGerald, presiding

- Call to Order
- Pledge of Allegiance
- Introduction of Guests
- Appointment of a Recording Secretary

11:15 am

Minutes of the Previous Meeting
 Introduction of Officers
 Presentation of Letters of Appreciation

- Determination of Quorum and Related Matters

Joe Dirksen, Secretary

New Business

Introduction of New Officers

- Report on Members Represented by Delegates to

Determining Quorum

11:30 am

Reports from the Committees
 Finance: *John Deane, Chairman*
 Energy: *John Deane, Chairman*
 Energy: *John Deane, Chairman*

- Reading of "Notice of Meeting" and "Proof of Mailing"

- Reading of Minutes of 21 March 2008

Annual Meeting

11:55 am

Sharing Thoughts
 Prayers of Comfort

President's Report

Bill FitzGerald, President

12:00 noon

Adjourns
 President: *Bill FitzGerald*

Manager's Report

Tim Gregory, Manager

12:05 pm

Luncheon
 St. Thomas Parish Center - Houma, LA
 Invocation: *John Deane, Vice President*

Power Supply Alternatives

15 January 2009 RFP: Summary and Results

Dick McCormick, Electrical Consultants Incorporated

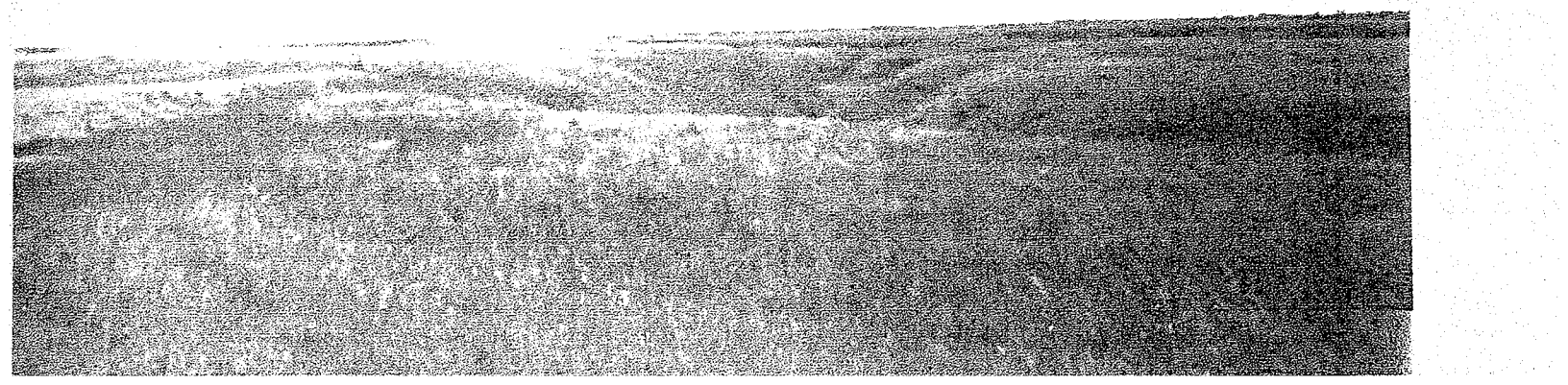
Highwood Generating Station - Progress Reports

Project Manager for Permitting and EIS - *Jeff Chaffee*

Project Principal Engineering and Design - *Kevin Conaway*

Transmission Interconnection and Wind Project - *Dick McCormick*

HGS Finance and Accounting - *Randy Boyan*



BALANCE SHEETS

ASSETS

	12/31/2005	12/31/2007
PROPERTY, PLANT & EQUIPMENT		
Office Equipment	\$ 75,547	\$ 30,662
Automobile	39,580	35,600
Telemetry Equipment	275,104	275,104
Total Property & Equipment	390,231	341,366
Accumulated Depreciation	(233,750)	(223,381)
Total Fixed Assets	156,481	117,985
OTHER ASSETS AND INVESTMENTS		
Due From Central Montana Electric	645,165	688,751
Investments in Associated Organizations	64,722	23,806
Total Other Assets and Investments	709,887	712,557
CURRENT ASSETS		
Cash - Operations	831,044	2,759,108
Accounts Receivable - Members	4,685,282	3,167,060
Accounts Receivable - Deposits	90,017	-
Due from SME	1,662,398	-
Accounts Receivable - Other	-	559,604
Accrued Interest Receivable	-	2,889
Prepaid Expenses	24,895	21,163
Certificates of Deposit	-	365,712
CFC - Commercial Paper	1,859,715	-
Total Current Assets	9,153,351	6,875,536
CONTRACTS TO BE RECEIVED		
Prepaid Water Rights	1,186,062	975,211
Rent Deposit	6,400	1,400
Prepaid Transmission Deposits	358,600	358,600
Preliminary Surveys and Investigations	20,638,169	16,577,934
Other Deferred Debit - Tie Line	338,273	374,718
Total Project Assets	22,527,504	18,287,863
TOTAL ASSETS	\$32,547,223	\$25,993,941

LIABILITIES & EQUITY

EQUITY		
Memberships	\$ 3,000	\$ 3,000
Patronage Capital	8,580,761	8,279,267
Capital - Project Development	13,702,712	11,587,155
Total Equity	22,286,473	19,869,422
CURRENT LIABILITIES		
Accounts Payable	6,423,485	6,109,394
Accrued Compensated Absences	24,389	15,125
Line of Credit - First Interstate Bank	1,245,343	-
Member Deposits	2,537,674	-
Total Current Liabilities	10,230,891	6,124,519
LONG TERM LIABILITIES		
Loan - First Interstate Bank	29,859	-
Total Long Term Liabilities	29,859	-
TOTAL LIABILITIES & EQUITY	\$32,547,223	\$25,993,941

STATEMENTS OF REVENUES & EXPENSES

	2017	2016
OPERATING REVENUES		
Electric Power and Energy Revenue	\$36,033,344	\$30,774,630
OPERATING EXPENSES		
Cost of Power Purchases	27,266,172	22,193,280
Transmission Service Tariffs	6,511,790	6,264,086
Total Cost of Power	<u>33,777,961</u>	<u>28,457,366</u>
Net Operating Revenue	<u>2,255,383</u>	<u>2,317,264</u>
OPERATING EXPENSES		
Metering Telephone Expense	42,799	38,209
Salaries and Wages	330,730	321,536
Office Supplies and Expenses	35,408	25,357
Outside Services - Legal	283,043	186,583
Outside Services - Audit and Accounting	39,532	47,351
Outside Services - Marketing and Administration	41,087	89,962
Outside Services - Engineering	581	8,365
Insurance Expense	10,621	10,480
Employee Pension and Benefits	123,548	109,048
Trustee Fees and Expenses	53,570	123,316
Association Dues	40,707	42,378
Staff Travel and Other	51,389	101,256
Corporate, General, and Administration	703,673	36,116
Depreciation and Amortization	78,260	75,867
Taxes - Payroll	22,591	23,470
Operating Costs Allocated to Preliminary Surveys	(71,337)	(112,319)
Total Operating Expense	<u>1,186,203</u>	<u>1,126,975</u>
Operating Margins before Patronage		
Capital Credits and Non-Operating Margins	1,069,180	1,190,289
NON-OPERATING REVENUES		
Interest Income	36,653	120,182
Patronage Income	81,327	30,190
Other Income - NorthWestern Refund	463,651	204
Reimbursed Expenses - CME	89,027	22,759
Reimbursements and Billable Expenses	(35,063)	(39,177)
Settlement - CME	-	382,126
Interest Expense - Member Deposits	(14,309)	-
Total Non-Operating Margins	<u>623,286</u>	<u>516,284</u>
NET MARGINS	<u>\$1,692,466</u>	<u>\$1,706,573</u>

+100K

+67K

2

TOM KAISERSKI



Mr. Kaiserski is the Program Manager for the Energy Promotion and Development Division (EPD) in the Montana Department of Commerce. The Division was funded by HB 2 in May of 2007 and EPD is hard at work developing Montana's vast energy resources. EPD's focus at this time is developing electricity transmission projects that can access Montana energy resource areas and move power to load centers in the West.

Prior to taking this new position, Mr. Kaiserski worked as a Senior Economic Development Specialist with Governor Schweitzer's Office of Economic Development where he concentrated on energy development. Mr. Kaiserski has traveled around the region presenting information on energy policy which promotes developing of all of Montana's energy opportunities. This includes emphasis on developing wind, bio-fuels, coal, oil and gas energy sources that eastern Montana has in abundant supply which is one of the keys to national energy independence and revitalizing the economy of eastern Montana.

Mr. Kaiserski grew up in Los Angeles and has a bachelor's degree in earth science from Montana State University in Bozeman. Prior to coming on board with Governor Schweitzer's office in January 2005 he worked for 7 years as the Economic Development Coordinator for the Beartooth RC&ID, a regional economic and community development organization that serves a five county region around Billings, Montana. Mr. Kaiserski also worked as a community planner in Montana for over 10 years. Mr. Kaiserski is married to wife Teresa and has four children ranging in ages from 10 to 20.

PROJECT MILESTONES

2004	Formation of Project Development Team (7/04)
2004	Essential Baseline Studies Complete (10/04)
2004	• Electrical Field Forecast
2004	• Alternative Air Evaluation Study
2004	• Site Siting Study
2004	Long Term Financing Submitted (11/04)
2004	Preliminary Plant Design Complete (11/04)
2005	Land Options Secured (1/05)
2005	Bridge Financing Secured (2/05)
2005	Water Supply Contract Complete (5/05)
2005	Fuel Supply Test Burn Complete (10/05)
2005	Transmission Interconnection Study in Progress (6/05)
2005	Fuel Supply Memorandum in Progress (8/05)
2005	Air Quality Permit Submitted (9/05)
2005	Environmental Impact Statement Study Begins (9/05)
2006	Builder Bid Request Submitted (1/06)
2006	Decoded Water Application Submitted (2/06)
2006	Solid Waste Application Submitted to Montana Department of Environmental Quality (2/06)
2006	Draft Air Quality Permit Received from Montana Department of Environmental Quality (3/06)
2006	Application for Clean Renewable Energy Bonds for Wind Plants - Financing Submitted (3/06)
2006	State's Further Generation Ref Request Submitted (3/06)
2006	Draft Environmental Impact Statement Received (6/06)
2006	Allocation of Clean Renewable Energy Bonds (12/06)
2007	Final EIS Issued (2/07)
2007	Final Site Permit (5/07)
2007	Board of Decision on EIS (7/07)
2007	Solid Waste Disposal Permit (7/07)
2008	HEB Release C.O.D. (1/08)
2008	Favorable Zoning Decision (3/08)
2008	Purchased Property (8/08)
2008	Obtained Co-sited County Location Conforming Permit (10/08)
2008	Commencement of Construction (10/08)
2008	Air Permit Review Final (11/08)
2009	Evaluations of a Natural Gas Fired Combined Cycle Gas Turbine Turbine Base Load Electric Generation Facility (1/09)

MINUTES OF THE ANNUAL MEETING OF THE MEMBERSHIP OF SOUTHERN MONTANA ELECTRIC GENERATION AND TRANSMISSION COOPERATIVE, INC.

Pursuant to notice, a meeting of the Membership of Southern Montana Electric Generation and Transmission Cooperative, Inc. was scheduled and held at Saint Thomas Parish Center, 2055 Woody Drive, Billings, Montana 59101, on Friday, March 21, 2008. The representatives of the six members were present throughout the meeting. The representatives were: John Prinkki (Beartooth Electric); Coleen Balzarini (City of Great Falls); Joe Dirksen (Jerome Electric); Bill FitzGerald (Mid-Yellowstone); Gerhard Helm (Tongue River Electric); and Dave Kelsey (Yellowstone Valley Electric).

President Bill FitzGerald called the meeting to order at approximately 9:15 AM, followed by the Pledge of Allegiance. He welcomed the following guests: Brian Altman (Bonneville Power Administration); Robert Harris (Western Area Power Administration); Denver Schlaeppli (RUS); Linda Lewis (CFC); Sheryl Mayo (PPL); Steve Lehman (Crowley Law Firm); Russell Malson; Jim Reno (Yellowstone County Commissioner); and Rick Matusiak (CPA).

President FitzGerald called on John Prinkki for the invocation. He then designated Mike McCarter recording secretary for the meeting.

Joe Dirksen, Secretary/Treasurer, reported that representatives of all members were present and that they constituted a quorum. He then read the Notice of the Fifth Annual Meeting of the Members of Southern Montana Electric Generation and Transmission Cooperative, Inc. and the Pool and Certificate of Due Mailing of Notice of Annual Meeting.

John Prinkki moved that the Members dispense with the reading of the minutes of the March 17, 2007, Fourth Annual Meeting, as set forth in the 2008 Annual Report, and approve the minutes of that meeting. Dave Kelsey seconded the motion. The motion carried by unanimous vote.

President FitzGerald then gave his report regarding the affairs of SME. His report included the following points:

- At the close of 2007 SME had good margins and adequate funds.
- SME continues to seek an alternative, affordable source of funding for the HGS.
- As SME prepares for the loss of BPA power, its rates have increased an average of 5.5% per year since 2004 but rates are still among the lowest in the United States and approximately 46% less than for Northwestern Energy residential customers.
- The HGS project still faces challenges but the key to success is to meet those challenges.

President FitzGerald then turned the meeting over to General Manager Tim Gregori.

Manager Gregori thanked President FitzGerald and the Board of Trustees for their work the previous year. He reported that despite obstacles in the path of the Highwood Generation Station, SME is on the verge of constructing the first member owned generation facility in Montana, which will provide a clean, reliable source of affordable power for SMP's members. He noted that the project has taken longer than SME would have liked and that the goal of environmentalists is to impede progress. He told the audience that Duane Urquhart is ill but sent a message saying that the Urquhart family continues to support the project.

Manager Gregori then listed the project successes, including the issuance of the Air Quality Permit, a favorable Record of Decision from RUS, issuance of a solid waste disposal license, execution of agreements for raw, potable and waste water agreements between SME and the city of Great Falls, execution of a Large Generation Integration Agreement with Northwestern Energy, completion and execution of a Project Labor Agreement with Montana unions, execution of a Memorandum of Understanding for operating and spinning reserves, and rezoning of the Salem site for heavy industrial use.

He then gave a power point presentation. Among the points he made during the presentation were the following:

- A dispatch curve for March 17, 2008 showed that had the HGS been operational on that date, it could have dispatched all its generation up to \$95 per megawatt.
- The reason for sizing the HGS to provide peaking power is because the cost of power during peak hours is the most expensive power.
- Justification for constructing the HGS is the same now as in 2003 when it was conceived.
- The HGS will provide significant benefits to the city of Great Falls.
- SME has been a good environmental steward.

- SME must still secure financing for the HGS and resolve some internal problems but it has the will to succeed.

Manager Gregori then called on Jeff Chaffee of Bison Engineering for a report on environmental matters.

Mr. Chaffee reiterated the milestones covered by Manager Gregori and then discussed specific environmental challenges SME is still facing. He reported that three issues were raised with respect to the Air Quality Permit, one by SME. The SME issue concerns the test method for measuring condensable. He reported that SME is close to settling that issue and that he expects the EPA to approve a new test method. The other two issues were raised by MEIC, which asserts that a BACT analysis should be done for carbon dioxide emissions and a specific BACT analysis should be done for PM2.5. He reported that a two day hearing had been held before the Board of Environmental Review in January and that at worst SME will be required to go through more process. He noted that the HGS is a clean project, use latest technology, and compares favorably with the proposed Future Gen facility. He then introduced Nathan Bartow, another Bison environmental engineer, to report on carbon capture. Mr. Chaffee noted that SME is as far along in its analysis of carbon capture feasibility and technology as anyone.

Mr. Bartow discussed the two major pieces of carbon capture legislation pending in Congress - Lieberman-Warner and Bingaman-Spector. The former bill proposes a cap and trade system which does not contain a fair allocation for cooperatives. He noted that a speaker at a recent conference he attended predicted its enactment would cost 10,000 to 15,000 jobs in Montana and by 2030 would cost the average family \$5,400. He said the Bingaman-Spector is similar to Lieberman-Warner but with better limits and safeguards. It is receiving more support from industry and labor than Lieberman-Warner.

He went on to report on recent Wyoming legislation and the Montana Governor's Climate Change Advisory Committee. He said that in the previous month Wyoming had enacted carbon legislation regulating pore space for carbon dioxide injection and requiring a carbon analysis for future projects. The Montana Committee has made fifty-four (54) recommendations, fifteen of which are being considered by the Montana Environmental Quality Council for legislation. He said the ones being considered are "low-hanging fruit," i.e., the proposals most easily implemented.

Bartow informed the members that the HGS design will accommodate later addition of carbon dioxide capture technology. He also noted that from a global perspective, the carbon dioxide contributions from HGS will be extremely small. Nonetheless, SME has prepared a draft carbon mitigation plan targeting a 60% carbon dioxide emissions reduction, 50% through capture and sequestration and 10% through carbon offsets. That would bring the HGS in line with the emissions from a natural gas plant. He said that marketing the captured carbon dioxide for enhanced oil recovery is essential to contain costs. SME's Carbon Capture and Sequestration Technical Workgroup will be meeting again in 2008 and SME will be submitting an application to the United States Department of Energy for a DOE Clean Energy Coal Initiative loan/guarantee.

The meeting was recessed for a short time. When recalled to order, President FitzGerald called on Manager Gregori to continue. Manager Gregori introduced Kevin Cavanaugh from Stanley Consulting, the project engineering firm.

Mr. Cavanaugh reported on HGS engineering progress. Among the points he made during his presentation were the following:

- The HGS has been moved off the historical landmark.
- A right-of-way team has been constituted, a manual developed, and alignment sheets prepared.
- Right-of-way efforts will begin to move forward now that zoning has been approved.
- In conjunction with an analysis of carbon capture technology, Stanley engineers visited the AJ S. Shelley Point Power Plant in Oklahoma. That plant only captures 3% of carbon dioxide emitted. Power point slides showed that even then the capture equipment covered a large area of the plant site.

- Stanley supported rezoning efforts. Its efforts included environmental analysis, a traffic impact study and traffic mitigation recommendations for construction, and lighting design to minimize night time light. It also developed a line-of-sight model from the Lewis and Clark Staging Area.

Upon completion of Mr. Cavanaugh's remarks, Manager Gregori reported that both Keith Hausman and Dick McCormick, who were scheduled to speak, were unable to make the meeting.

Manager Gregori then recognized Randy Boysun, SME's outside accountant, to report on accounting activities related to the HGS. Randy reported briefly, saying that SME's financial forecasts had been refreshed for RUS.

Ken Reich then reported on legal activities. He reiterated project milestones already met. He informed the members that the Board of Environmental Review had rejected the Carbon Dioxide BACT challenge but that the PM2.5 challenge is still pending, with a further hearing scheduled for April 21 and 22. He noted that no state in the United States has ever set a limit specifically for PM2.5. He said that if the BER sustains the PM2.5 challenge, then the permit will be remanded back to the Department of Environmental Quality for further analysis.

He reported that the challenge to the RUS record of decision had been dismissed in light of the fact that RUS is not now funding new coal generation facilities. He opined that in light of the dismissal, there is no further need for further consultations regarding the landmark.

Finally, he said that SME can expect more legal challenges since they are a fact of life for projects like the HGS.

Mr. Boysun then presented the financial report. He referred members to the unaudited financial report in the Annual Report. He directed their attention to the balance sheet and statement of revenues at pages 4 and 5. The balance sheet shows an approximate 35% increase in assets, most of which was due to the HGS. The HGS investment increased \$7.2 million, 41% attributable to environmental issues, 40% to engineering, and 19% to overhead and other items. He further reported that the CoBank buy of credit was paid in full through a cash call and that as a result SME's equity in the HGS project is now at 75%.

He further reported that:

- Letters of Credit are now required for power purchases from PPL (\$1.4 million) and from transmission from Northwestern Energy (\$365,000). The PPL letter of credit will have been increased when SME begins receiving additional PPL supply in July 2008.
- The escrow account for the EIS has been closed out and the EIS contractor paid in full.
- Revenues increased \$4.2 million due to increased costs and use.
- Operating costs increased 14%.

Finally, he reported that SME's statements for 2007 are currently being audited by auditor Rick Matusial.

Mr. Matusial reported that during the past couple of years he has been unable to complete the SME audit in time for the annual meeting due to Northwestern Energy's delays in reporting year end energy imbalances. This year further information is needed with respect to the billing issue with Central Montana Electric, resolution of which is pending and which will determine what amount will be booked as a receivable. He acknowledged that SME Bylaws require that the audited annual report be presented at the annual meeting but noted that accounting standards preclude his certifying an audit at this time and that he is bound by those standards.

Upon conclusion of the financial report, Gary Helm moved to reseat the current trustees. Joe Dirkson seconded the motion. The motion was adopted by unanimous vote.

John Prinkki then moved to ratify all legal actions taken by SME during the prior year. Joe Dirkson seconded the motion and it was adopted without dissenting vote.

Manager Gregori then introduced Roy Palk, former CFO of East Kentucky Power Cooperative for the keynote address.

Following the keynote address, Manager Gregori reminded those present that the names of the entities through which SME is seeking financing are confidential.

President FitzGerald noted that the members must still consider the audited financial statements when they become available and that the members should consider amending the bylaws in light of the difficulties experienced with respect to completing the audit by the date presently set for the annual meeting. He said that he was therefore recessing the meeting, rather than adjourning, and that the annual meeting will be reconvened at a later time.

The 2007 Annual Meeting of Southern Montana members was then recessed until further notice.

President

Attest: _____

Secretary



ST. THOMAS THE APOSTLE CHURCH
Parish Center
2055 Woody Drive • Billings, MT 59102